

## MINNESOTA • REVENUE

# Property Tax System Overview

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Prepared for the Property Tax Working Group



# Introduction

Property tax in Minnesota is an “ad valorem” tax. This means that property is taxed according to its value. Property tax is a major source of revenue for local units of government including cities, counties, and school districts. It is also the only tax that is subject to local review. Values and classifications may be appealed to Local and County Boards of Appeal and Equalization and/or Tax Court. In addition, public hearings must be held each year by local units of government to discuss the upcoming year’s budget. Appraised values that are used for tax purposes must be accurate and equalized so the tax burden will be distributed fairly. Property taxes are a stable and predictable source of revenue for local units of government. However, the property tax system in Minnesota is also complicated and may not be predictable for the taxpayer. It often does not reflect ability to pay based on a taxpayer’s current income.

Minnesota’s power of taxation is found in *Article X* of the Constitution of the State of Minnesota. The article states that the power of taxation will never be surrendered, suspended, or contracted away. It also states that the taxes will be uniform upon the same class of subjects and will be levied for public purposes. This “uniformity clause” is important in that it permits the use of different classification rates to be applied to different classes of property. Article X also exempts certain types of properties from taxation, including public schools, public hospitals, and churches.

## A brief history of the property tax

The property tax was established by the Minnesota territorial legislature. The classification system was established in 1913 with 4 classes of property. The number of classes has increased dramatically since then.

In the early 1970’s, the so-called Minnesota Miracle replaced local property taxes with state aids to schools and other local governments. Minnesota’s state-shared revenues became (and remain) among the most generous in the nation. In exchange for the state aid, local governments were subjected to state-imposed property tax levy limits and restricted from imposing other taxes. The state sales and income taxes were raised to pay for the aid increases. As intended, local property taxes declined sharply. In 1971, property taxes comprised more than 42 percent of total state and local tax revenues. By the early 1980s – when the impact of the Minnesota Miracle peaked – property taxes were down to less than 24 percent of total state and local tax revenues.

From 1968 until 2001, property taxes were solely levied and collected at the local level. In 2001, the Legislature enacted the state general tax, which is paid only by some classes of property, including seasonal residential recreational and commercial/industrial property. This portion of the property tax is levied by the state, but it is collected by each county as part of the property tax.

Further reform in 2001 aimed at making the property tax more purely a local tax. It provided for full state funding of the state-determined general education formula, and reduced aid to cities and counties. It reformed property tax classification rates to ensure more equity in the taxation of different kinds of property.

Classification, state aids and levy limitations aren’t the only tool that has been used to control tax burdens. Value limitations and exclusions, tax deferrals, tax credits and refunds have all been implemented in myriad ways over the past 50 years.

## Administering and monitoring the system

The tax is administered by 87 counties, several computer consortiums, and software vendors. The system is comprised of approximately 2,800 individual taxing jurisdictions (cities, schools, counties, towns, special districts) and over 2.5 million property parcels. The state is also very diverse with respect to topography, land use, and real estate markets which greatly affect both property classification determinations and market valuations. The total market value of taxable property in the State exceeds \$ 580 billion and the system generates over \$7.5 billion in tax revenue including over \$700 million in state general tax.

The Department of Revenue performs oversight and administration of the state's property tax system. Oversight roles include: the equalization of local assessments through sales ratio studies, review of assessments, and the issuance of orders through the State Board of Equalization; monitoring compliance with state property tax laws; licensing assessors through the State Board of Assessors; providing training, manuals, directives, and other assistance to county assessors, auditors, and treasurers; and providing research and information about property taxes to policy makers and the public.

The 2010 legislature asked that the department provide additional information regarding property tax principles. To better evaluate the various property tax proposals that come before the legislature, the following basic property tax principles should be taken into consideration:

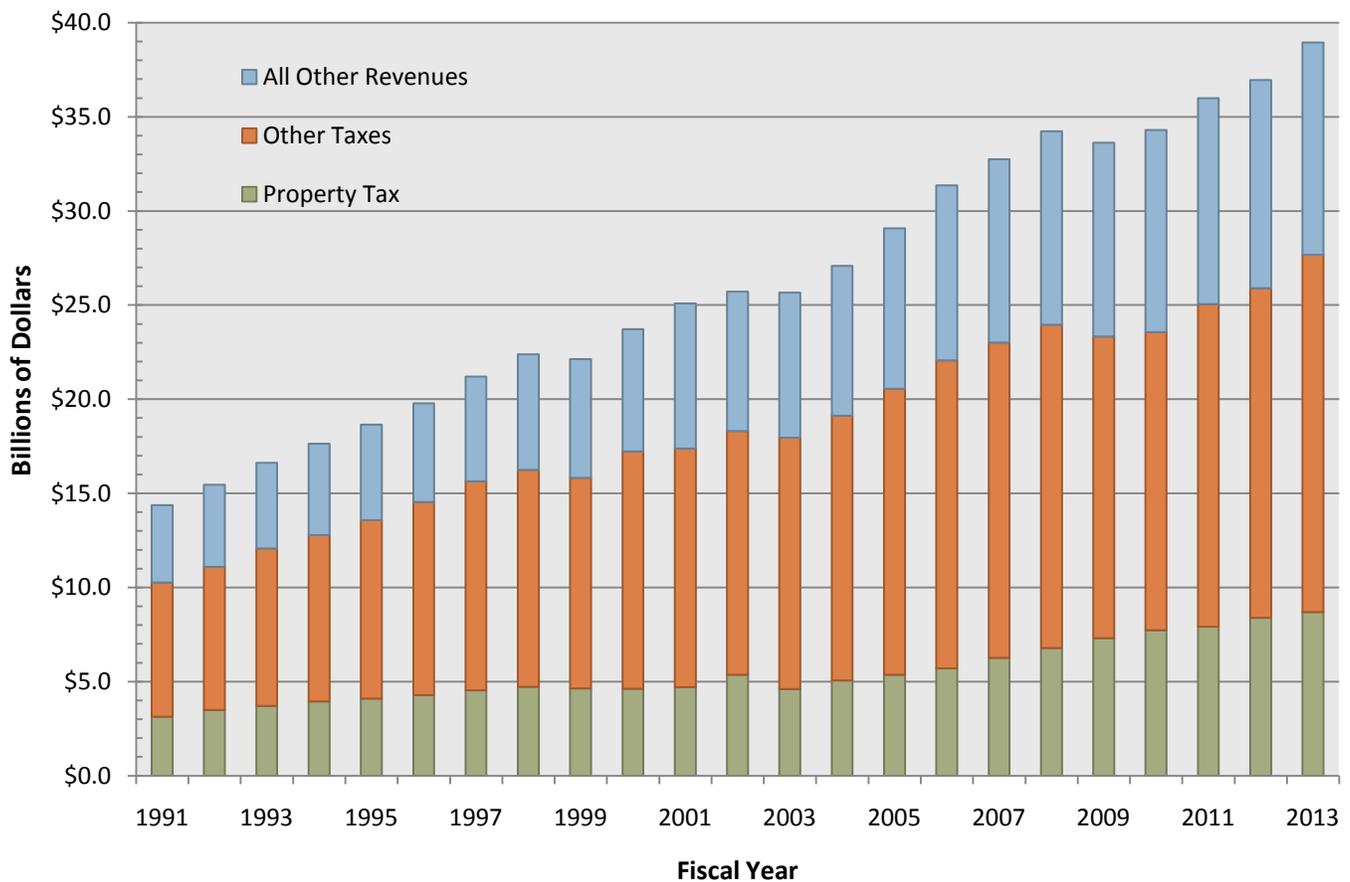
- (1) transparency and understandability;
- (2) simplicity and efficiency;
- (3) equity;
- (4) stability and predictability;
- (5) compliance and accountability;
- (6) competitiveness; and
- (7) responsiveness to economic conditions.

The same legislation identified a number of reports and other resources that are *critical indicators* of the property tax system. The balance of this document reviews many of these indicators.

# Price of Government Report

The Price of Government report is a measure of the cost of all general government services statewide. It answers the question: **How much do Minnesotans pay to state and local governments in total?** It is comprehensive and includes nearly all revenues generated by state and local units of government as well as public school districts. All state taxes, property taxes, special assessments, fees and charges are included. Federal revenues are not included. The measure serves as a financial index for the cost of public services in Minnesota.

### Total Own Source Revenues for State & Local Governments



Source: Minnesota Department of Revenue and Price of Government, End of Session 2010

## Price of Government Report (continued)

The annual receipts collected by each unit of government are considered to represent the aggregate costs that Minnesota taxpayers pay for public services. The “Price of Government” measures that cost for each fiscal year relative to Minnesota Personal Income. The result is stated as a percentage of statewide personal income.

### Minnesota Price of Government State and Local Revenues as a % of Personal Income

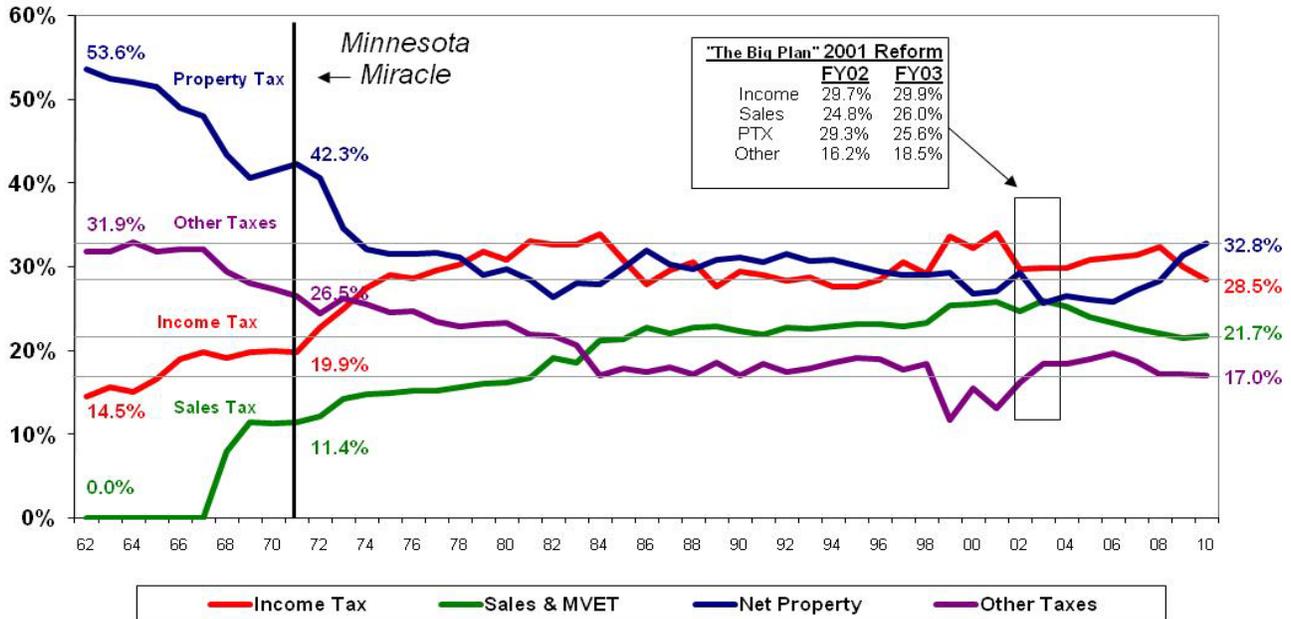


For calendar year 2009, fiscal year 2010, the “Price of Government” is estimated at 15.6 percent. In other words, for every dollar of Minnesota taxpayer personal income, 15.6 cents will be paid to the state and local governments for services during that year.

<http://www.mmb.state.mn.us/doc/budget/report-pog/may10.pdf>

# Price of Government Report (continued)

## History of Major Taxes Percent Share FY 1962 - 2010



Source: Minnesota Department of Revenue and Price of Government, End of Session 2010  
Includes sales tax rebates FY 1999-2001

The chart above shows the mix of tax collections by state and local governments. The Minnesota Miracle shifted the main source of education funding in the state from local taxes to state aids, reducing property taxes by instead increasing income and sales tax rates. The Big Plan 2001 Reform created a statewide property tax on business and cabin property and increased state aid to schools to replace the general education levy while increasing property tax relief to residential homesteads.

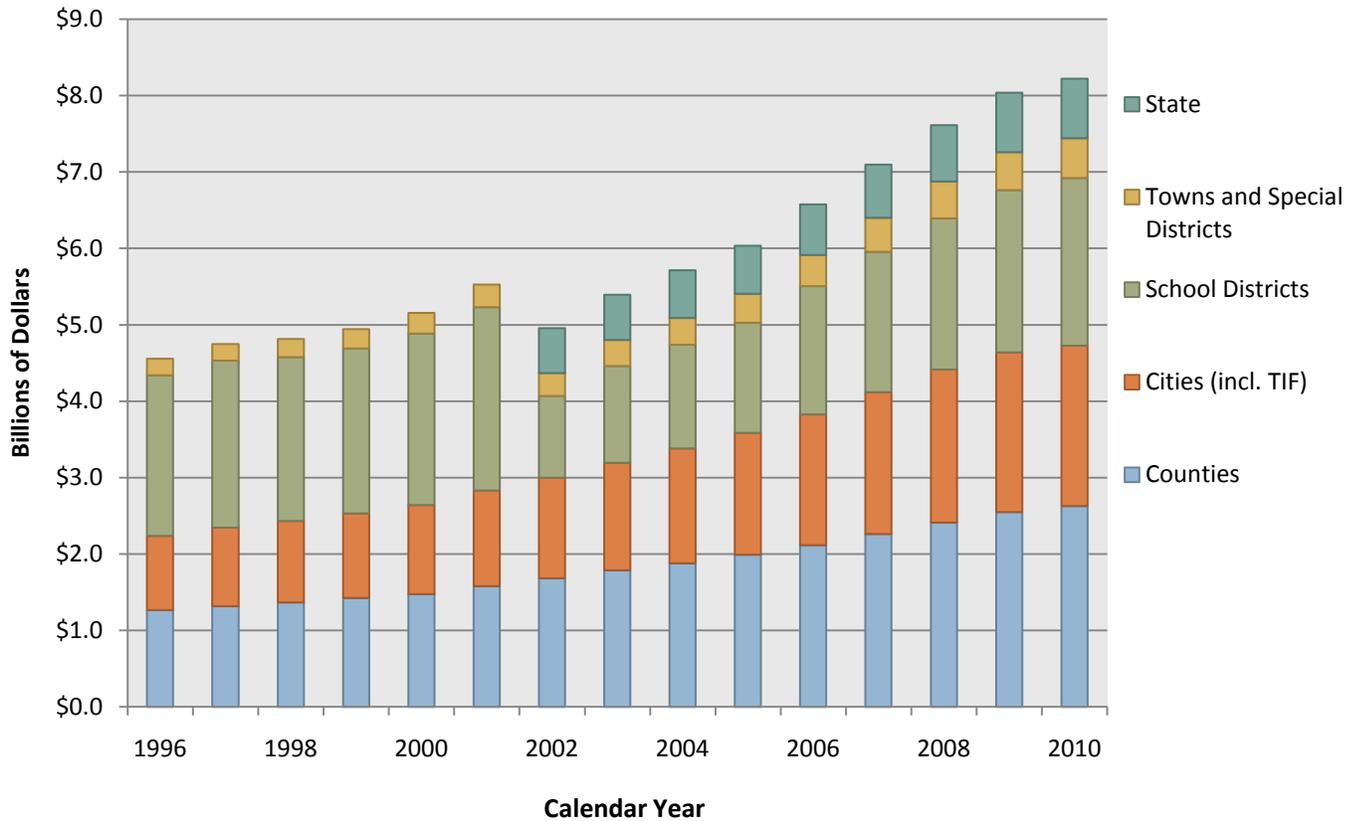
### Tax Collection Amounts (\$ Billions)

	Property Tax	Income Tax	Sales Taxes	Other Taxes
FY 2010	\$7.7	\$6.7	\$5.1	\$4.0
FY 2009	\$7.3	\$6.9	\$5.0	\$4.0
FY 2008	\$6.8	\$7.8	\$5.3	\$4.1
FY 2005	\$5.4	\$6.3	\$4.9	\$3.9
FY 2000	\$4.6	\$5.6	\$4.4	\$3.3
FY 1995	\$4.1	\$3.8	\$3.1	\$2.6
FY 1990	\$3.0	\$2.9	\$2.2	\$1.7

# Property Tax Levies

The table below shows property tax levies by jurisdiction. In the years immediately preceding the 2001 Big Plan reforms the average total increase in levies was 4%. From 2002 through 2008 the average increase was 7.5%. Two main contributors to the increased rate of change are aid cuts to cities and counties and growth in the passage of school referenda levies. Since the 2008 recession increases have moderated significantly despite continued cuts to city and county aids.

### Property Tax Levies by Jurisdictions



Source: Minnesota Department of Revenue

# Tax Incidence Report

The Minnesota Tax Incidence Study reports the distribution of state and local taxes in relation to taxpayer income. It answers the question, “Who pays Minnesota’s taxes?” The major objective is to provide taxpayers and policymakers with important information on the equity or fairness of the overall distribution of Minnesota taxes.

The following table shows projected 2011 net property tax by population decile, including business taxes that are ultimately bourn by Minnesotans through lower wages and higher prices. The table confirms the regressivity of the property tax.

**2011 Population Deciles - Amounts (\$Thousands) Property Tax Components**

Population Decile	Income Range	Percent Share of Household Income	Total Residential Taxes <sup>1</sup>	Nonresidential Local Property Taxes	State Property Tax	Property Tax Refund	Total Net Property Taxes	Property Tax as a % of Income	Total Tax as a % of Income
First	\$11,201 & Under	0.9%	\$148,039	\$56,711	\$12,062	-\$70,555	\$146,257	8.45%	22.1%
Second	\$11,202 - \$18,454	2.0%	155,951	54,659	14,352	-94,785	130,177	3.42%	11.2%
Third	\$18,455 - \$26,461	3.0%	236,064	65,644	18,141	-95,229	224,621	3.91%	11.1%
Fourth	\$26,462 - \$35,169	4.1%	299,881	81,407	20,983	-89,265	313,005	3.96%	11.7%
Fifth	\$35,170 - \$45,349	5.4%	391,286	105,854	25,540	-58,120	464,561	4.51%	12.8%
Sixth	\$45,350 - \$58,040	6.9%	466,853	124,434	28,725	-48,663	571,348	4.32%	12.5%
Seventh	\$58,041 - \$74,595	8.9%	566,515	136,370	35,131	-28,078	709,939	4.18%	12.5%
Eighth	\$74,596 - \$96,681	11.5%	634,384	134,538	40,445	-11,106	798,261	3.65%	12.1%
Ninth	\$96,682 - \$136,954	15.4%	784,774	193,758	52,102	-2,125	1,028,509	3.50%	11.9%
Tenth	\$136,955 & Over	41.8%	1,278,034	399,767	118,164	-1,874	1,794,091	2.25%	10.1%
<b>TOTALS</b>		100%	\$4,961,782	\$1,353,142	\$365,645	-\$499,800	\$6,180,769	3.24%	11.4%
Top 5%	Over \$193,687	31.0%	\$775,400	\$282,037	\$83,442	-\$1,036	\$1,139,843	1.93%	9.7%
Top 1%	Over \$481,439	16.0%	\$236,455	\$113,018	\$37,801	-\$144	\$387,129	1.27%	8.8%

<sup>1</sup> Includes seasonal recreational residential (cabins).

Source: 2009 Tax Incidence Report,  
MN Department of Revenue

[http://taxes.state.mn.us/legal\\_policy/pages/research\\_reports\\_content\\_incidence.aspx](http://taxes.state.mn.us/legal_policy/pages/research_reports_content_incidence.aspx)

# Homestead Property Tax Burden Report

This report focuses on the incidence of direct property taxes on homesteaded property. The property tax-income (Voss) database contains data on estimated market value, state-paid property tax refunds, net property tax, and homesteader income for each homestead in the state. The following table presents tax burdens by income range before and after the application of the homestead market value credit (HMVC) and property tax refund (PTR).

## Homestead Tax Burden by Income

Income range*	Median burden before MVHC	Median burden before PTR	Median burden after PTR
\$10,000 - \$30,000	7.6	6.4	3.8
\$30,000 - \$45,000	4.8	4.2	3.3
\$45,000 - \$65,000	3.7	3.3	3.1
\$65,000 - \$90,000	3.1	2.8	2.8
\$90,000 - \$125,000	2.6	2.5	2.4
\$125,000 or more	1.9	1.8	1.8
Overall	3.3	3.0	2.8

*\*Homesteads with income under \$10,000 not shown due to data issues*

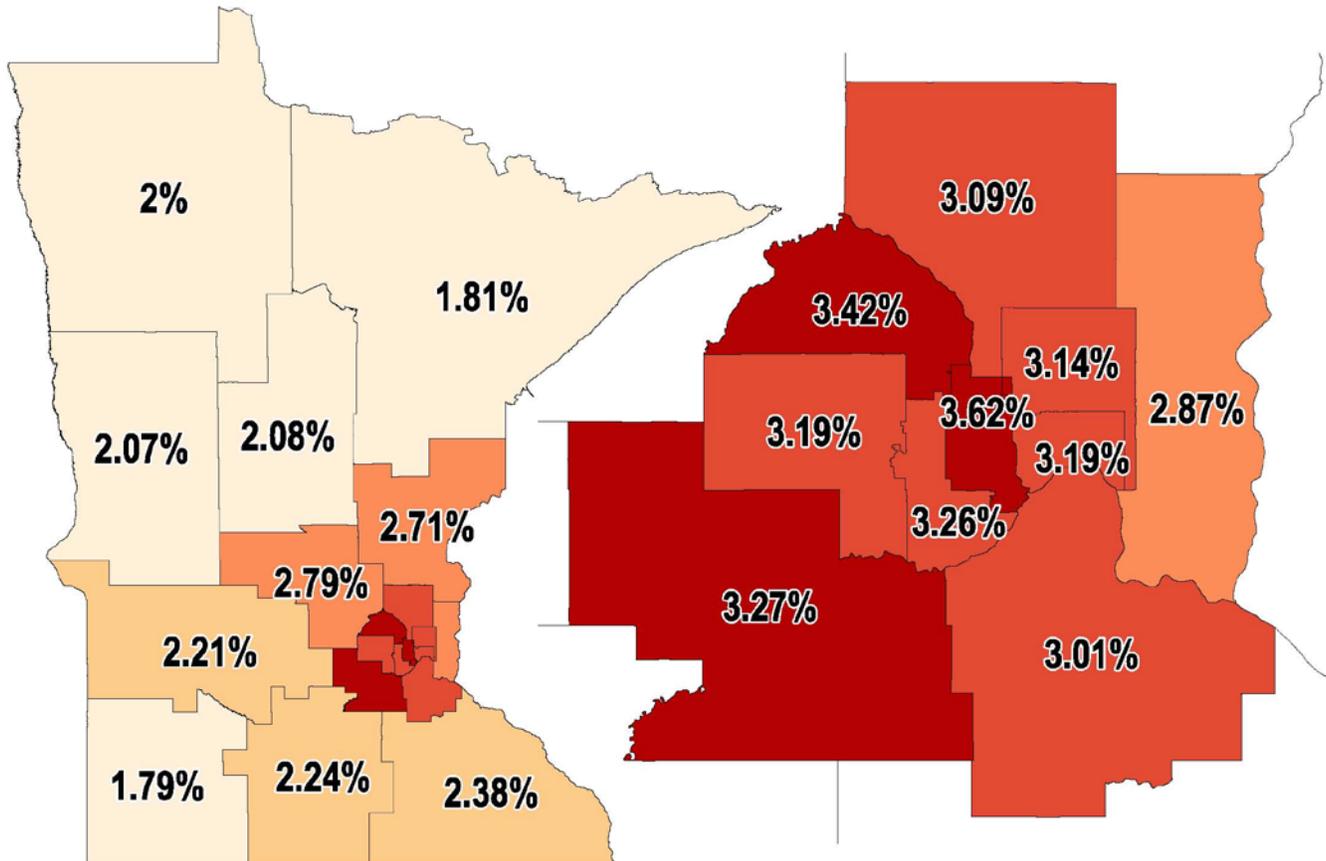
- As a percent of income, burdens are higher for lower income homesteaders. (Property tax is a tax on value, not income)
- MVHC makes the homestead property tax somewhat less regressive.
- The PTR program, which is income-based, has a much stronger moderating affect on lower income homesteaders' burdens.
- Under 10,000 income issue: needs more analysis to differentiate temporarily income poor from perennially poor. 39,000 households (3% of total)

Property tax burdens vary across regions, within regions, and among income ranges. Regional median tax burdens range from 3.62 percent of income in Minneapolis to 1.79 percent of income in Southwestern Minnesota.

[http://taxes.state.mn.us/property\\_tax\\_administrators/pages/other\\_supporting\\_content\\_vossreports\\_main.aspx](http://taxes.state.mn.us/property_tax_administrators/pages/other_supporting_content_vossreports_main.aspx)

# Homestead Property Tax Burden Report (continued)

## Regional Median Tax Burdens



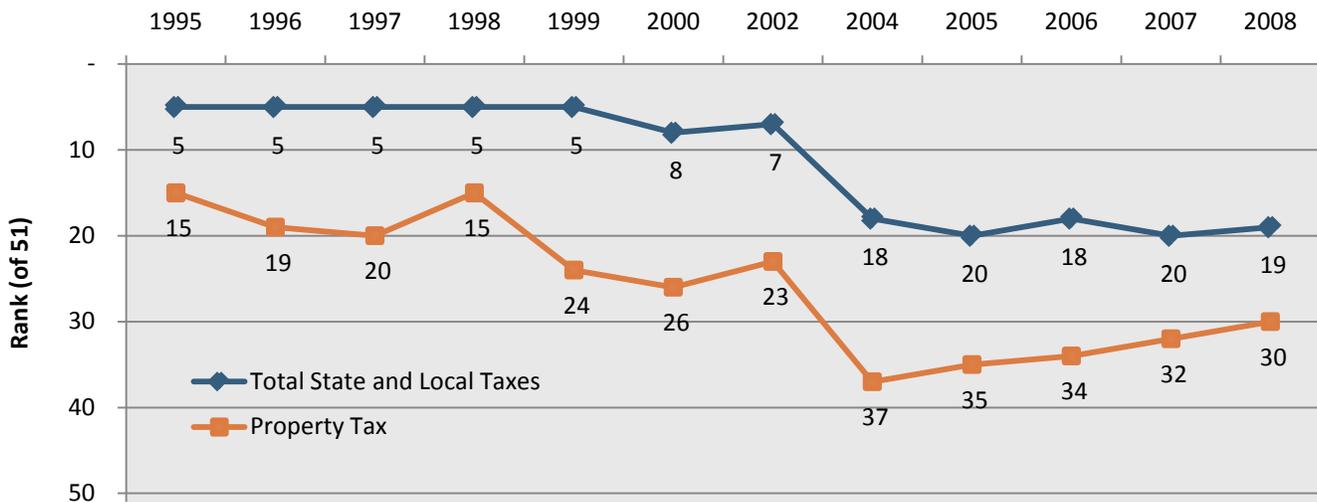
There are many possible reasons for variation in the average homestead tax burden, including:

- *Level of public services:* The level and cost of local spending varies. Townships provide fewer services than cities. School district referenda levies are not uniform. Community preferences for public goods and services vary.
- *Intergovernmental aid and other revenues:* Dependency on property tax varies based state/fed aid received and extent of fees, charges and other non-property tax revenues
- *Tax base composition and property tax classification system:* The amount of non-homesteaded property and state laws that establish the relative share of market value subject to tax profoundly impact the extent to which taxes are paid by homesteaders rather than owners of other types of property.
- *Property tax refunds, credits, exclusions:* tax liability is reduced if the homesteader qualifies for various programs

# State Tax Rankings

The Minnesota Department of Revenue calculates tax and revenue rankings for the 50 states and the District of Columbia based on U.S. Census Bureau government finance reports. The table below shows Minnesota's historical ranking for 1) total state and local taxes, and 2) property tax, as a percent of personal income.

**Minnesota's Tax Ranking  
State and Local Tax Collections as a Percent of Personal Income**



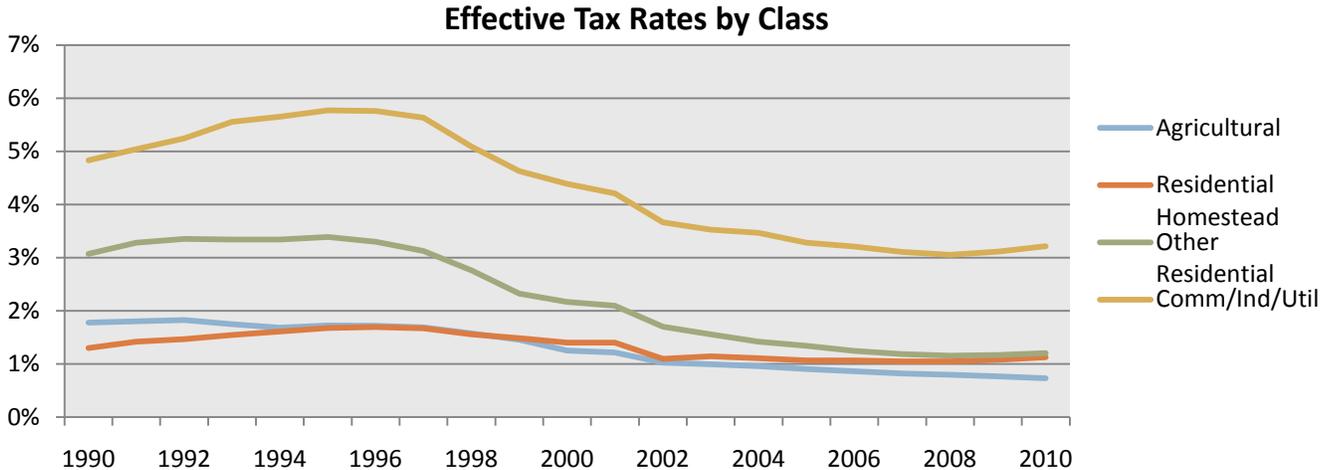
Source: Census Bureau, Fiscal Year Data and MN Department of Revenue

\*Data is unavailable for FY2001 & 2003. The U.S. Census Bureau did not publish state-by-state local government finances for those years.

[http://taxes.state.mn.us/legal\\_policy/pages/research\\_reports\\_tax\\_rankings.aspx](http://taxes.state.mn.us/legal_policy/pages/research_reports_tax_rankings.aspx)

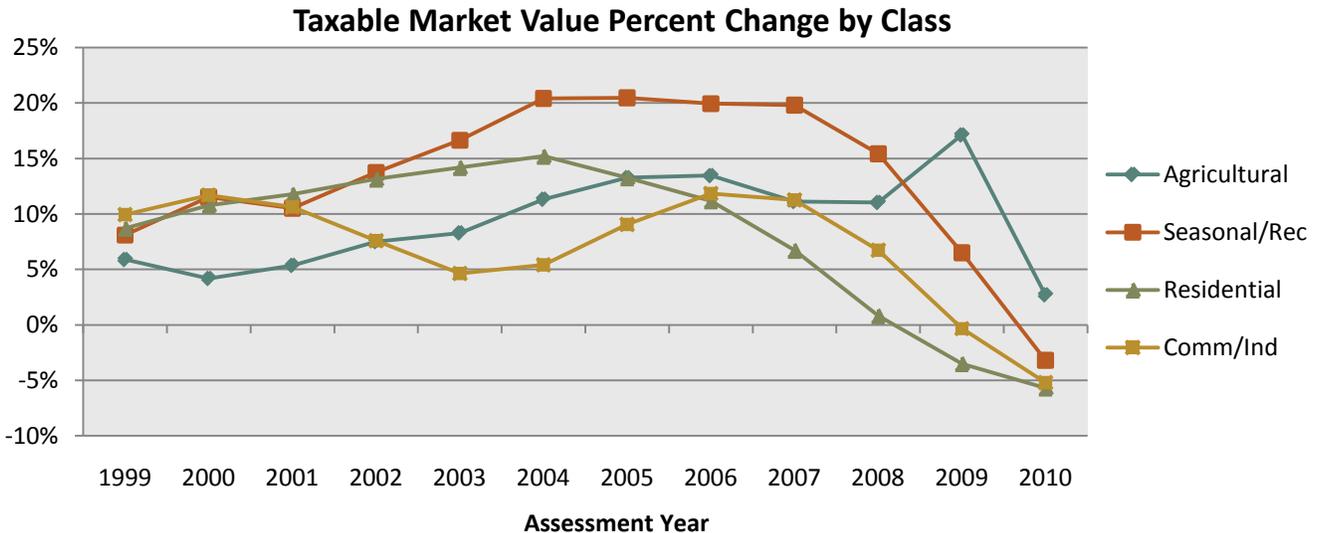
# Effective Tax Rates

Effective tax rates show the property taxes paid as a percent of the property’s taxable value. For every dollar of value, commercial, industrial and utility value pays three times the property taxes than other types of property. Effective tax rates decline when taxes increase more than value (or decrease less than value). Effective tax rates have risen for all property classes except farm for the last couple years after a decade of steady decline.



# Market Value Trends

The recent recession brought overall declines in taxable values in all property classes except agricultural (class 2a and 2b) property. Agricultural property saw a spike in value for assessment year 2009, used for taxes payable in 2010. Ag values have since moderated but are still increasing. When values change at different rates, tax burdens can shift among property types and state aids can shift among jurisdictions.



# Property Class Preference: Share of Market Value and Net Tax

This chart shows how classification, exclusions, deferrals and credits change the final incidence of the property tax. Preferred classes (residential and agricultural) pay less tax per dollar of value than commercial, industrial and utility property.

### 2010 Property Taxes by Class

